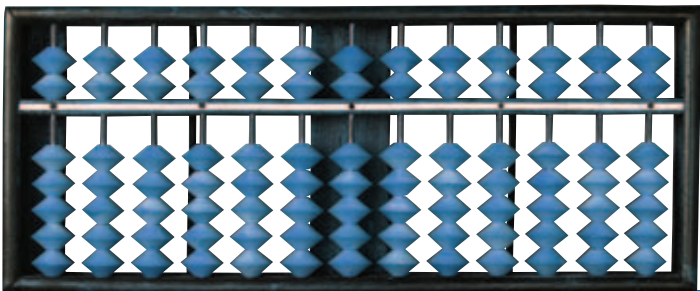


Serving on the audit committee of a **college or university** is an important undertaking. Recent scrutiny of financial responsibility in both the not-for-profit and for-profit...

Grant Thornton 



Audit committee handbook for higher education

...sectors has brought the role of the audit committee into the public eye. Grant Thornton LLP has created this audit committee handbook to provide an overview of what you can expect in your role and what will, in turn, be expected of you by the various stakeholders of the college or university.

Your college or university's most valuable asset is its reputation and good name. As an audit committee member, your fundamental task is to help the board of trustees assure the integrity and credibility of the college or university's financial statements and financial management. That task can be rewarding, yet challenging.

This handbook outlines the organization, functions and duties of an audit committee. It also covers some of the tax concerns affecting colleges or universities, including intermediate sanctions, private inurement and unrelated business income tax.

If you have further questions or require more detailed information than this booklet provides, please contact Grant Thornton's not-for-profit and higher education professionals for the answers you're looking for.

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The contents of this guide are intended for information purposes only and should not be construed as legal or accounting advice or opinion on any specific facts or circumstances. You should not rely on the contents of this guide as a substitute for obtaining legal or other professional counsel. This content is not intended to create, and receipt of it by you does not constitute, an attorney-client, accountant-client, or any other relationship. You are urged to consult with an attorney or an accountant regarding your own situation and any specific questions you may have.

2 Accountability and independence

The guiding principles of the audit committee can be summed up in two words: accountability and independence.

A college or university is accountable to its various stakeholders for the use of funds received either as tuition and fees, donations, grants, or exchange contracts. These include the donors of the funds and the people who use the resources of the institution. Stakeholders include students, parents, alumni, donors, governmental agencies, foundations and organizations that provide research grants.

In addition, the college or university's tax-exempt status carries with it a much broader responsibility to society at large. Tax-exempt status is, in part, recognition of the societal value of the services a college or university performs. It is also a method by which all taxpayers underwrite these services. In effect, every taxpayer is a stakeholder in your institution.

The primary role of the audit committee is to instill confidence that the funds entrusted to the institution are used in a manner consistent with good financial practice. This includes making certain that funds are used only for the purposes for which they were intended and in ways that do not violate the principles that resulted in tax-exempt status.

Independence

The audit committee is charged with protecting not only financial assets, but also the academic institution's most important asset: its good name and reputation.

To maintain its independence, the audit committee is charged with ensuring that:

- The audit committee itself is independent of the college or university's management and its external auditor, focusing solely on representing the board's responsibility to protect the mission and best interests of the college or university.
- The institution's internal auditor is independent from management and that the auditor's opinion is based only on its independent professional judgment.
- The college or university's trustees and management are independent from vendors to the institution or, if not independent, that the relationships are fully disclosed.

A college or university's audit committee has three main missions.

First, it represents the board of trustees in overseeing the establishment and implementation of appropriate accounting policies and internal controls so that financial reporting is accurate and reliable and fraud is avoided. Therefore, the audit committee needs to work diligently to ensure proper stewardship over the institution's assets and to protect the institution's reputation through fiscal transparency.

Second, the audit committee assesses the business risks for the college or university and determines whether it is planning adequately for those risks. To do this, the committee should review the institution's overall risk management profile, including investment practices, disaster recovery plans, compliance with donor/grantor requirements, and insurance coverage.

Third, the audit committee monitors the roles of the board, management, and internal and external auditors to ensure that the institution follows good financial governance practices.

The exact responsibilities assigned to the audit committee to fulfill these missions will vary from institution to institution, depending on its size and the nature of its activities.

The tasks most commonly assigned to an audit committee include:

- Recommending to the board, or appointing directly, an independent audit firm.
 - Ensuring the appropriateness of financial statement presentation and the adequacy of footnote disclosures.
 - Ensuring clear communication of financial information using appropriate communication methodology.
 - Reviewing the scope and plan for the independent audit.
 - Receiving and acting upon the results of the audit with the external auditors, including reporting the results to the full board.
 - Providing oversight of the internal control structure.
 - Approving the annual internal audit plan and review the resulting reports prepared by the internal auditor.
 - Reviewing or approving the contracting for any non-audit services provided by the external auditors.
 - Resolving disagreements between auditors and management.
 - Reviewing the Form 990 that is filed with the Internal Revenue Service (IRS).
- Audit committee members should meet with the college or university's auditors at least twice a year — once to discuss the auditor's workplan and once to review their findings before they are presented to the board. In most cases, however, audit committee members' duties are more involved.

In larger colleges and universities that have an internal audit department, the audit committee approves the department's workplan, receives its reports and oversees the department's

staffing and performance. In some cases, the internal audit department reports administratively to the chief financial officer, but its workplan and reports should be approved and received by the audit committee. The internal audit director should have confidential access to the audit committee chair. Additionally, the committee should evaluate the performance of the internal audit director.

The committee should make sure the internal audit and external audit plans are thorough and complement each other.

As part of its duties, the audit committee should be charged with monitoring specific policies that represent best practices, such as:

- A code of ethics for the college or university, including the board;
- A conflict-of-interest policy for the institution, including the board (the code of ethics and the conflict-of-interest policy can also be incorporated into one policy);
- A whistle-blower policy through which stakeholders, including employees, can raise concerns without fear of retaliation; and
- A records-retention policy so that critical documents are preserved for a certain period of time.

Some colleges and universities incorporate audit committee functions into their finance committees. The trend, however, is toward the establishment of separate audit committees with standing committee

status. The role of an audit committee is quite different than the roles usually assigned to a finance committee.

A finance committee's principal task is the approval and monitoring of the budget, which requires individuals who understand the programmatic structure and mission of the college or university. An audit committee, however, puts the focus on understanding the fundamental principles of accountability, financial reporting and internal controls and its members are likely to view the college or university more critically.

If your audit committee is new, consider working with the board of trustees to draft an audit committee charter that spells out, in writing, the committee's exact responsibilities. (For an example of an audit committee charter, see Appendix I.)

Composition of the audit committee

The audit committee generally should be composed of three to five members drawn from the board of trustees. All audit committee members should be independent of institutional management: i.e., they should not have accepted, directly or indirectly, any salary or compensatory fees from the academic institution.

Most or all of the audit committee members should have a solid grounding in business and finance and a good understanding of internal control issues. They should be financially literate: i.e., be able to read and interpret a financial statement and be conversant in basic

financial terminology.

One or more of the members should be a financial expert with a professional knowledge of financial reporting (including generally accepted accounting principles or GAAP), business risk assessment and internal control practices. Ideally, there should also be individuals on the committee with specific knowledge of college and university accounting and business issues.

Of course, the supply of individuals with such backgrounds will vary considerably from one institution to the next. If your college or university does not have trustees with a financial background, you should actively recruit such individuals, including bankers, accountants and other financial professionals, to fill this need.

The number of finance committee members serving on the audit committee should be limited. The audit committee monitors the business operations of the institution creating a conflict of interest for finance committee members serving on the audit committee.

It is very important for audit committee members to have a healthy skepticism about what they are told and about how the college or university operates. The audit committee should ask management difficult questions about its practices and policies and pursue issues until it is satisfied with the answers. Individuals who are uncomfortable asking difficult

questions or coming to critical conclusions can't serve effectively on an audit committee.

The final characteristic an audit committee member must possess is a willingness to commit the time and effort necessary to do the job.

Depending on your institution's size and structure, this time commitment may be substantial.

Member liability

Trustees of colleges and universities face potential personal legal liabilities, so the question of whether serving on an audit committee entails any further legal risk is a legitimate one.

Since many of the events that could result in liability for the board as a whole stem from failures in internal controls, the audit committee is partly responsible for protecting itself — and the rest of the board — from such liability.

Before considering any board position, you may wish to investigate whether your college or university carries adequate directors and officers' (D&O) insurance coverage. D&O insurance coverage protects boards against allegations of wrongdoing.

When reviewing the D&O policy, be sure it covers legal costs, which will be incurred regardless of the outcome of a lawsuit. You may also wish to consult with legal counsel regarding the specific laws in your state concerning your exposure.

6 The inside perspective: Working within a college or university

An effective audit committee must work with a variety of groups within a college or university.

Specifically, the audit committee works with the board of trustees as a whole, with the institution's management team, and, if one exists, with the internal audit department. Understanding the audit committee's role in each of these relationships is essential.

The audit committee and the board of trustees

The audit committee represents the board of trustees in fulfilling some of the board's responsibilities for financial oversight of the academic institution.

Although a share of the audit committee may be made up of trustees, not all audit committee members need be trustees. Including trustees provides the expertise needed, while non-trustees provide an independent perspective.

The committee should report at least twice a year to the board on 1) results of external and internal audits and any issues that arose in those audits that merit the board's attention, 2) issues of financial accountability and business risk that the college or university faces, 3) any internal control or procedural issues, 4) new systems and controls evaluated and put in place, and 5) regulatory issues.

The audit committee and management

Management is responsible for creating and maintaining internal controls and the audit committee is responsible for seeing that those controls are adequate and implemented. While the committee will work collaboratively with the external auditors, internal auditors — if any — and management, the committee is independent of each of these groups and must come to its own conclusions.

As part of the audit process, the external auditors will consider the college or university's internal controls. Their audit findings should include a list of control issues they believe need addressing and suggestions for improving them. If you have internal auditors, they, too, will test and report on internal control issues.

The audit committee should discuss these control issues with management and review management's plans for fixing them. In some cases, management may recommend against implementing an auditor's suggestions on a cost-benefit basis, or they may recommend an alternative solution.

The audit committee should consider these suggestions, discuss them with the auditors, if necessary, and bring any unresolved material disputes to the board's attention.

The audit committee can also provide management with a valuable, objective sounding board for any issues dealing with internal controls or the public trust. By giving management an opportunity to discuss sensitive matters up front, the audit committee can help head off potential problems before they arise.

Working with internal auditors

Today, audit committees are expecting more from their internal audit functions. If your college or university has an internal audit function, the audit committee should work with it in much the same way that it works with your external auditors.

The committee should review and approve the internal audit work plan, including the areas within the organization targeted for detailed examination. The audit committee should receive and review the group's findings and discuss any control issues that have arisen.

Audit committees are also looking to internal auditors to monitor the status of various findings and recommendations to ensure appropriate corrective action plans are implemented.

Some internal auditors are developing more elaborate systems to identify findings as material weaknesses, significant deficiencies or reportable conditions.

Internal auditors may require periodic reports to be issued by the auditee on the status of the corrective action plan, require the auditee to present their responses to the audit committee or require a re-audit after a certain period of time.

8 A vigilant team: Working with your external auditors

The audit committee will spend much of its time dealing with your academic institution's external auditors, who have been appointed by the committee (or the board itself) to assist in assessing the college or university's financial condition and financial oversight.

The pre-audit meeting

One of the audit committee's most important jobs is working with your auditors to ensure an effective audit effort.

Prior to the audit, the audit committee should meet with the external auditors to review their workplans. An auditor's workplan spells out its strategy for conducting the audit. It will identify those areas that the auditor has targeted for the greatest scrutiny, indicate staffing levels and set a schedule for the audit.

The audit committee should review the workplan with the auditors in light of the committee's own concerns regarding business risks, internal controls and other issues. If the audit committee has concerns about a specific financial area, the auditor's workplan should include that area.

If the plan does not include the area, the committee must decide whether to add it, or substitute it, for another area. It must then determine the cost of any additional work it requests, and whether there are steps the college or university can take to help control the cost of the audit.

The pre-audit meeting is also the venue for the auditors to solicit input from the committee on areas of financial statement and internal control risk, including the risk of fraud.

The audit committee should also discuss with the auditors any internal control or other issues raised by the prior year's audit. The committee should inform the auditor of the steps, if any, management has taken to resolve those issues, and should seek the auditor's opinion of those solutions.

The post-audit meeting

As its name would imply, the post-audit meeting is held after the auditors complete their fieldwork. At this meeting, the audit committee will discuss many items with the auditors.

The auditors will present audit results, including draft reports, supplemental financial information and related auditor reports for review and discussion by the committee. In addition, the auditors' professional standards require that they communicate certain matters to the committee.

Statement of Auditing Standards (SAS) No. 60, "Communications of Internal Control Structure Matters Noted in an Audit," requires auditors to report to the audit committee matters that "... in the auditors' judgment... represent reportable conditions in the design or operations of the internal control structure, which would adversely affect the college or university's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements."

These are referred to as a "reportable conditions" and are normally included in the management advisory comment letter with the auditors' other recommendations to management.

SAS No. 61, "Communications with Audit Committees," mandates that the auditor discuss the following issues:

- *The auditors' responsibility under GAAP*

The auditors must communicate their level of responsibility for matters such as review of, and reports related to, the internal control structure and whether the financial statements are free of material misstatement.

Auditors also must make sure that the committee understands the fundamental concepts of an audit. Specifically, they should make it clear to the committee that an audit is designed to deliver reasonable, not absolute, assurance that the financial statements are presented fairly and in accordance with GAAP.

- *Significant accounting policies*

The auditors should inform the audit committee about selection of, changes in or application of significant accounting principles and financial reporting practices and policies. Discussions should include the effect of these practices and policies in controversial or emerging areas and any likely future changes.

- *Judgments of management and accounting estimates*

Accounting estimates are an integral part of financial statements. They can be particularly sensitive because of the possibility that future amounts may differ significantly from those estimates. The auditors should educate the audit committee on the process that management employed to formulate sensitive accounting estimates and on the basis for the auditors' conclusions regarding the reasonableness of those estimates. The allowance for uncollectible accounts receivable is an example of a significant estimate.

- *Significant audit adjustments*

The audit committee should be informed of all significant adjustments made as a result of the audit that may not have been otherwise detected by management. Management should also provide the audit committee with a listing of proposed audit adjustments that were not recorded because the amounts involved were not considered material to the financial statements, either on an individual basis or in the aggregate.

- *Responsibility for other information in documents containing audited financial statements*

The auditors should discuss their responsibility and involvement with information in other documents containing audited financial statements, such as published annual reports.

- *Disagreements with management*

The auditors should discuss any disagreements with management about matters related to accounting principles, financial reporting practices and policies, and auditing matters that could be significant to the financial statements or the auditors' report. These disagreements might include application of accounting principles, judgments about accounting estimates, the scope of the audit, or the wording of the auditors' report.

- *Consultation with other accountants*

If the auditors are aware that management has consulted with other auditors about auditing, accounting or financial reporting matters, the views of those auditors should be discussed with the audit committee.

- *Major issues discussed with management prior to retention*
The auditors and the audit committee should review any major management issues raised when the auditors were retained, including discussions about accounting principles, financial reporting practices and policies, and auditing standards and procedures.
- *Difficulties encountered in performing the audit*
The auditors should inform the audit committee of serious difficulties in dealing with management while performing the audit, such as failure to provide necessary information, unreasonable delays, unavailability of client personnel, or failure of client personnel to complete requested schedules on a timely basis.

In addition to these topics, the audit committee may also want to discuss the following areas with the auditors:

- Assessment of the audit compared with anticipated results.
- Any need to expand audit procedures and the reasons for doing so.
- Changes in report format or note disclosures from the previous year and the reasons for these changes.
- Evaluation of personnel involved in preparing and controlling the financial information.
- Non-audit services provided to the college or university by the external auditors for the prior year and related fees.
- The report of the audit committee that the audit committee chairperson will present to the governing board of trustees.

Generally, during the post-audit meeting, the audit committee will meet in separate executive sessions with the external auditors, the internal auditors and with financial management.

If an executive session deals with issues including compliance or whistleblower situations, the audit committee may consider having its own legal counsel present.

Evaluating your external auditors

Part of the audit committee's responsibility is to evaluate the qualities of your external auditors. The audit committee should consider many factors when evaluating the auditors, including:

- *Industry expertise* — The higher education sector has a variety of specific accounting requirements that an auditor should know intimately. While strong experience in the not-for-profit sector, in general, is a desirable characteristic in your auditor, experience specifically in higher education is also a strong plus. This should include knowledge of the different accounting standards for not-for-profit colleges versus governmental colleges.
- *Tax capabilities* — You should look for a firm with a strong tax specialty in the not-for-profit area. Colleges and universities have many tax issues and, because tax-exempt status is critical, it is vital that your audit firm understand relevant tax issues.
- *Manpower and location* — Does your audit firm have sufficient staff to do the job? Insufficient staff can lead to delays or poor performance. Where is its staff located? If your audit will be staffed from out of town, travel expenses may add to your bill.
- *Depth of expert resources* — The audit firm should have the depth of expertise to provide its own staff and your college or university with information and experience that provides critical business advice to improve your institution's operations.
- *Price* — While price should not be the sole determining factor in your auditor choice, it is certainly a consideration. Be sure to evaluate both what the auditors propose to do for their fee and their ability to serve the special needs of your college or university.
- *Use of technology* — Information technology plays an important role in the accounting profession. Your auditors will have to work with electronic data from your systems. An ability to use technology allows the auditor to work more effectively and efficiently with less disruption of your staff.

- *Chemistry* — The audit committee, management and people throughout your institution will all have to work closely with your auditors. The personal chemistry between key personnel in your college or university and the partners, managers and staff of your auditors is very important.

An academic institution may put its audit work out for proposal for a variety of reasons, some having to do with the auditor, some having to do with the college or university itself, and some having to do with a policy of periodically re-bidding all procurement arrangements.

If it becomes necessary to solicit proposals, the audit committee, usually with management's assistance, should prepare or approve a list of potential accounting firms and a request for proposal (RFP). The RFP spells out the scope of services your academic institution requires, as well as specific questions that management would like proposing firms to answer.

The management team, or the audit committee itself, usually reviews the proposals and identifies a short list of candidates for oral presentations. The audit committee, often in conjunction with management, conducts the oral interviews and then presents its selection to the board for approval.

Audit and compliance committee

Many not-for-profit organizations are studying the possibility of enhancing the responsibility of the audit committee by adding compliance oversight responsibilities. To cover the scope of its duties, some organizations have changed the name of the audit committee to audit and compliance committee.

Compliance would entail a review and monitoring of legal and regulatory issues, which are presently beyond the responsibility of most audit committees.

14 Special financial, tax and regulatory concerns for colleges and universities

While audit committee members should have a solid grounding in finance before being appointed, they also need a basic understanding of the specific financial management issues that face colleges, universities and other not-for-profit organizations.

Issues audit committee members should consider as they address their institution's controls and financial reports are tax-exempt status, private inurement, intermediate sanctions, unrelated business income tax, issues related to donations, and the importance of staff.

Tax-exempt status

One of the greatest responsibilities for audit committee members — and, indeed, for all board members — is to ensure that the institution is in compliance with tax laws and does not endanger its tax-exempt status.

Losing tax-exempt status could devastate your academic institution through resulting large income tax liabilities, excise taxes (some of which may be imposed on officers and directors personally), denied tax deductions for your contributors, loss of government grants, ineligibility for reduced postage rates, and loss of various state tax exemptions.

Private inurement

Some transactions may result in the loss of tax-exempt status for a college or university. One of the greatest dangers, both to your institution's tax-exempt status and to its public image, is private inurement.

Private inurement may result when the college or university's assets or earnings are used for the benefit of an insider rather than for the good of the academic institution itself or its stakeholders.

Insiders are generally trustees, officers and certain key employees, as well as their families or businesses. Embezzlement or theft are obvious cases, but there are other more common examples.

For instance, compensation paid to employees that is disproportionately high compared with their duties could be considered private inurement. Excessive travel or entertainment expenses could also constitute private inurement. Procuring merchandise or services from vendors who are relatives or friends of insiders at higher than market rates or for other inappropriate reasons can also constitute private inurement.

You should closely scrutinize all transactions with insiders because of the inherent conflict of interest that exists. Not-for-profit organizations are also prohibited from distributing their earnings to their members.

Another major consequence of private inurement is damage to the college or university's reputation. Therefore, the audit committee and your academic institution as a whole should set and follow very strict standards concerning compensation and benefits; travel, entertainment and other expenses; and any financial dealings between the college or university and any parties related to staff, management or the board.

In addition, under the excess benefit rules, called "intermediate sanctions," improper dealing with insiders can also result in severe financial penalties in the form of excise taxes imposed directly on those insiders in their personal capacity who took unfair advantage of a Section 501(c)(3) or 501(c)(4) organization and on those managers who knowingly approved the transactions. These provisions are discussed in more detail in the next section.

Intermediate sanctions

The intermediate sanctions apply to organizations exempt from tax under Sections 501(c)(3) and 501(c)(4) and provide another strong reason to guard against private inurement.

Where the IRS previously only had the option of revoking a college or university's tax-exempt status as a penalty for private inurement, it can now force "disqualified persons" (generally trustees, officers or key

employees) benefiting from inappropriate transactions to pay an excise tax of 25 percent of the excess benefit received.

Those persons must also undo the inappropriate transaction by returning the excess benefit, including interest, to the organization or face an additional excise tax of 200 percent of the improper benefit.

In short, they have to at least pay a 25 percent excise tax on the improper benefit and then return the money they are taxed on — a stiff penalty, indeed.

Any officer, director, trustee, or similarly empowered person within the organization who knowingly and willfully approves the transaction also faces an excise tax of 10 percent of the excess benefit — up to a limit of \$10,000 per transaction.

A transaction is covered if the benefit provided to the insider exceeds the value of the consideration the organization receives. This consideration can consist of services provided in exchange for compensation.

Typical transactions covered include unreasonable salaries and benefits, selling goods, property, or services to the organization for more than they are worth, or paying less than fair market value for the institution's assets.

Persons who have a substantial influence over the academic institution's affairs are covered by the law. They are called "disqualified persons." This determination is based on facts and circumstances and generally will include members of the governing body (the board), the chief executive officer, chief operating officer, and chief financial officer.

Audit committee members are disqualified persons if they are members of the board.

Once someone is covered by this definition, that person, his or her family members, and any business in which they own a 35 percent interest is also included. Even when persons resign from the college or university, they retain classification as a disqualified person for five years.

As an audit committee member, you should ensure that the institution has procedures in place to prevent conflicts of interest and excessive payments to disqualified persons.

All transactions involving insiders should be approved by the board of trustees or a committee that has no conflicts of interest with the person whose transaction is under consideration. You should also make sure that all compensation and benefits, including those provided to you as a trustee or officer, are properly disclosed on Form 990 and, if taxable, reported on Form 1099 or Form W-2 as appropriate.

Intermediate sanctions violations also carry a heavy public relations cost. Academic institutions must disclose the full details of any excess benefit transactions, and the names of the individuals involved, on the annual information return, Form 990.

Because these forms are public documents and are often reviewed by potential funders, these disclosures could be very damaging. Finally, many state attorneys general have broad powers to impose additional penalties on persons who misuse charitable assets. Guarding against intermediate sanctions is a vital audit committee duty.

Unrelated business income tax

Colleges and universities sometimes conduct activities that generate income that is unrelated to their tax-exempt purposes.

The IRS imposes an unrelated business income tax (UBIT) on income generated from these activities. While unrelated business income can arise from many activities, the sale of advertising space in a college or university's newsletter is a good example of income that is almost always considered unrelated business income.

The Internal Revenue Code imposes income taxes on the net income generated from your unrelated business activities even though the net proceeds are used for tax-exempt purposes.

There are two items to keep in mind concerning UBIT. First, the audit committee needs to ensure that the college or university's unrelated business activities do not become the primary focus of the institution. Excessive involvement in unrelated business activities can threaten the college or university's tax-exempt status.

Second, the audit committee should realize that such activities, even after paying UBIT, can be a valuable source of income for the college or university.

Issues related to donations

One key difference between not-for-profit organizations and for-profit businesses is the source of revenue. For-profit businesses are paid in exchange for goods or services. Customers that do not receive goods or services will complain, providing a built-in financial control.

Not-for-profit organizations, on the other hand, often rely heavily on donations or dues, for which the donor may not receive goods or services in return. These one-way, or non-reciprocal, transactions present internal control issues that the audit committee should ensure the college or university addresses.

Fund-raising activities may differ, but you must address the question of developing controls that protect contributions. Your external auditor should be able to recommend any necessary improvements in your system of internal control over donations.

Not-for-profit organizations or related charitable foundations that intend to solicit donations may have to register with the state attorney general before these solicitations occur. Organizations that solicit donations nationwide may be required to register in approximately 40 states.

In addition, federal and state regulations normally require solicitations for dues and contributions to contain certain specified language.

Finally, charities are required to follow the quid pro quo rules when they provide certain goods or services to donors in exchange for contributions. The failure to register with the state attorneys general, if required, or include the required notices could subject you to additional taxes or financial penalties.

The importance of your management team

The best single control that your institution can use to safeguard against trouble is an effective management team.

Your chief financial officer (CFO), controller and other financial personnel should be professional, well-trained and fairly compensated. Your job, and the job of your auditors, will be much easier — and the risk of internal control and other problems significantly lessened — if your staff has the appropriate experience and training to do their jobs.

To mitigate potential risks, it is also important to do an up-front background check on senior financial and executive staff.

You can take a number of steps to ensure a strong financial staff.

Ask your auditors for their impression of your CFO, controller and other financial staff during the post-audit meeting. Your auditors are often in the best position to evaluate not only your internal controls, but also the people you rely on to enforce them.

They also can knowledgeably compare your people and your compensation and benefits packages with those at similar colleges or universities.

How high is the turnover rate among your financial staff? High turnover makes it difficult to maintain a consistent control environment. If you believe that turnover may be threatening your institution's controls, you may need to bring it to the attention of the board or explore possible solutions with management.

Be sure that your institution maintains a strong core of skilled professionals, and that the rest of your financial team receives adequate training and supervision.

When your primary focus is on the balance sheet, it can often be easy to overlook the human factor. Make sure you don't.

As this brief overview demonstrates, an audit committee's job is varied and challenging. However, while an audit committee's duties will differ at each college or university, there is one overriding responsibility — maintaining vigilance.

Consider the various scandals that have befallen not-for-profit organizations. Some could have been averted had a vigilant audit committee — with the support of the full board — raised questions about internal controls, salaries and policies.

As an audit committee member, asking those questions — and ensuring satisfactory answers — is your responsibility. Your board, your academic institution, the students that your institution serves, and the taxpaying public depend on your diligence.

In an environment in which confidence in many institutions is eroding, all not-for-profit organizations are under closer scrutiny than ever before.

If your institution, your board, and your audit committee do not ask the tough questions, someone else very likely will.

APPENDIX I: SAMPLE AUDIT COMMITTEE CHARTER

Membership

The audit committee will consist of five board members who are appointed by the board of trustees to staggered terms. These individuals, or their immediate relatives, shall not hold a salaried position with the academic institution nor be employed by any entity that provides services for a fee to the institution.

The Chair of the audit committee shall be selected by the board of trustees according to the board's usual procedures for making such appointments.

At least one of the members of the committee shall be knowledgeable, by training and experience, in generally accepted accounting principles (GAAP), the preparation of financial statements and the principles of internal control.

Functions and responsibilities

The board has full authority and ultimate responsibility for the stewardship and management of all resources entrusted to the organization. The board has established the audit committee to oversee the annual audit of the academic institutions financial statements by a public accounting firm and to monitor the review, establishment and implementation of accounting policies and internal controls.

The audit committee shall assume the following responsibilities to accomplish its charge:

- Review and update the audit committee's charter annually or as deemed necessary.
- Recommend the selection and retention of the independent public accountants for the college or university to the board.
- Recommend to the board, when the audit committee deems it advisable, that the independent public accountants engages in specific studies and reports regarding auditing matters, accounting procedures and other matters.
- Review annual financial statements, including any adjustments to those statements recommended by the independent public accountants, and any significant issues that arose in connection with the preparation of those financial statements.
- In consultation with the independent public accountants, recommend to management inclusion of financial disclosures in audited financial statements.
- Review, as appropriate and in consultation with the independent public accountants, accounting policies, internal controls and procedures of the organization as well as any management responses to comments relating to those policies and procedures.

- Evaluate the business risks of the institution and plans to mitigate risk, including requiring management to communicate its risk assessments to the committee.
- Investigate, when the audit committee deems it necessary, potential or actual improprieties in the organization's operations.
- Meet at least annually with the senior management and the independent public accountants to discuss any issues arising from the audit committee's responsibilities.
- Meet at least twice annually with the independent public accountants, or more frequently as circumstances require, to discuss any issues arising from the audit committee's responsibilities. Two such meetings will be an audit planning meeting to adopt the scope of the upcoming audit and a post-audit meeting to receive the results of the audit.
- The audit committee may request the presence of members of management or others to attend meetings and provide pertinent information as necessary, including review of advisory services and related fees provided by the independent public accountants.
- Meeting at least annually with management (outside the presence of the independent public accountants) to discuss management's evaluation of the work performed by the independent public accountants.
- Obtaining from management and external advisors reports relating to accounting, tax, regulatory, governance, investment, and other business matters.
- Obtaining from management its assessment of the business risks facing the organization and its plans to mitigate those risks.
- Recommending to the board a conflict-of-interest policy, recommending changes as needed, and ensuring the college or university's compliance with its policy on at least an annual basis.
- Recommending to the board a code of ethical conduct, recommending changes as needed, and ensuring that a system has been established to enforce this code for all staff and volunteers.
- Obtaining the advice of outside consultants and professionals (including, but not limited to, retention of special legal counsel) to advise the audit committee on matters within the scope of its charge.
- Submitting the minutes of all meetings of the audit committee to the board in a timely manner.
- Reporting to the board, either in writing or in person, at least once a year.
- Reviewing Form 990, 990-T and related state filings to ensure compliance with tax laws.

APPENDIX II: SAMPLE AUDIT COMMITTEE MEETING PLAN

The audit planning meeting will include these items:

1. Review and discuss with external auditors the scope and plan for the current year's audit.
2. Examine areas of significant audit emphasis (e.g., this year's fund-raising campaign, compliance with Office of Management and Budget Circular A-133, etc.).
3. Discuss significant new and pending accounting principles, financial reporting practices or auditing matters with external auditors.
4. Review management response to the external auditor's management advisory letter resulting from the prior year audit, including plan of action, if necessary.
5. Review the internal audit plan and scope for the year with internal audit manager (if there is such a function). Receive and review reports from internal auditors.

The post-audit meeting will include these items:

1. Review the status of the current year's audit with the external auditors and discuss matters under consideration, including new disclosures and anticipated major variances or changes in year-end financial statements.
2. Review the results of the investigation of items requested by the committee.
3. Review the draft financial statements and the applicable auditors' report.
4. Receive the report to the audit committee from the external auditors regarding required communications.
5. Receive recommendations from the external auditors to management resulting from the audit, including "reportable conditions."
6. Meet separately and privately, in executive session, with external auditors.
7. Meet separately and privately, in executive session, with internal auditors.
8. Meet separately and privately, in executive session, with financial management.

The audit committee may request the presence of members of management or others to attend meetings and provide pertinent information as necessary.

Other matters which should receive consideration for discussion include:

1. Significant findings during the year, including the status of prior year management recommendations.
2. Any difficulties encountered in the course of performing audit work, including any restrictions on the scope of activities or access to required information.
3. Significant revisions or adjustments to the auditors' work plan as initially approved by the audit committee.
4. The auditors' independent qualitative judgments about the appropriateness, not just the acceptability, of the accounting principles and the clarity of the financial disclosure practices used or proposed to be adopted by the organization.
5. Confirm and assure the independence of the independent public accountants, including review of advisory services and related fees provided by the independent public accountants.

APPENDIX III: SAMPLE RECORDS-RETENTION PLAN

RECORD CATEGORY	DESCRIPTION OF RECORDS	MANNER OF RECORD KEEPING	RETENTION PERIOD	DISPOSITION
General	Correspondence	Compile and store current correspondence in appropriate subject files or in accordance with general corporate filing guidelines.	Seven years	Archive only correspondence important to business activities. Useless documents should be recycled or shredded.
	Accounts payable, ledgers and schedules	Compile and file records on an annual basis.	Seven years. Store with financial records.	Archive with financial records and shred after three years of storage.
	Accounts receivable, ledgers and schedules	Compile and file on an annual basis.	Seven years. store with financial records.	Archive with financial records and shred after three years of storage.
	Annual information returns (IRS Forms 990)	Federal law requires that copies of the three most recent years' returns be kept in the organization's headquarters and be made available for public inspection.	Permanent. Store with financial records.	Not applicable
	Audit reports	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Bank statements and reconciliations	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Cash books	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Chart of accounts	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Cancelled checks	For important payments, i.e., taxes, purchases of property, special contracts, etc., checks should be filed with the papers pertaining to the underlying transaction. Otherwise, compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Depreciation schedules	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Duplicate deposit slips	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.

RECORD CATEGORY	DESCRIPTION OF RECORDS	MANNER OF RECORD KEEPING	RETENTION PERIOD	DISPOSITION
General	Duplicate deposit slips	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Expense analyses and distribution schedules	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Year-end financial statements (others are optional)	Compile and file on an annual basis.	Permanent. Store with financial records.	Not applicable
	General/private ledgers, year-end trial balances	Compile and file on an annual basis.	Seven years. Store with financial records	Shred at the end of the retention period.
	Journal entries	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Notes receivable, ledgers and schedules	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Payroll records and summaries	Compile and file records on an annual basis.	Permanent. Store with financial records.	Shred at the end of the retention period.
	Petty cash vouchers	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Property records, including costs, depreciation reserves, year-end trial balances, depreciation schedules, blueprints and plans.	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Tax returns, worksheets and revenue agents' reports	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Time cards	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Vouchers (invoices) for payments to vendors and employees, including allowances and reimbursements of employees, officers and consultants for travel and entertainment expenses	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.

RECORD CATEGORY	DESCRIPTION OF RECORDS	MANNER OF RECORD KEEPING	RETENTION PERIOD	DISPOSITION
General	Withholding tax statements	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
Governance	Board of directors' minutes, notes and reports from all years	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Governing documents, including articles of incorporation, bylaws, amendments and other related documents	File documents with other corporate records.	Permanent. Store with financial records.	Not applicable
Grants	Proposals, original contract agreements, supporting data, accounting documents, financials, subrecipient policy reports, time cards, invoices for payments to subawardees, subaward agreements, procurement documents, A-133 audits and related correspondence	Compile and file records on an annual basis.	Seven years. Store with financial records.	Archive with grant records for three years at the end of the retention period following the filing of the closing report and acceptance by the funding agency.
Human resources	Employment applications	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Personnel files (current)	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Personnel files (from date of termination)	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Retirement and pension records	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Records of pension paid to employees or beneficiaries (after final payment)	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Insurance policies (expired)	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Insurance records, current accident reports, claims	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Garnishments	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.

RECORD CATEGORY	DESCRIPTION OF RECORDS	MANNER OF RECORD KEEPING	RETENTION PERIOD	DISPOSITION
Whistle-blower	Records relating to employee complaints or concerns pursuant to the organization's whistle-blower policy	Compile and file records on an annual basis.	Seven years; notwithstanding any shorter period provided above for the particular category of document. Store with other whistle-blower records.	Unless otherwise provided above for the particular category of document, shred at the end of the retention period.

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- *Planned giving: A board member's perspective*
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